STRENGTHENING OF LOCAL GOVERNMENT ADMINISTRATIONS

(CO-0155)

EXECUTIVE SUMMARY

BORROWER:	Financiera de Desarrollo Territorial S.A. (FINDETER).
GUARANTOR:	Republic of Colombia.
EXECUTING AGENCY:	FINDETER and the Ministry of Finance and Public Credit.

AMOUNT AND SOURCE:	IDB:	US$40.0 million (OC)
	CAF cofinancing:	US$25.0 millionLocal coun
	Total:	US$72.5 million
FINANCIAL TERMS AND CONDITIONS:	Amortization period:	20 years
	Disbursement period:	42 months
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	United States dollars from the Single-Currency Facility.
COFINANCING:	Andean Development Corporation (CAF)	
	Amortization period:	8 years
	Disbursement period:	2 years
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%

OBJECTIVES:

The overall objective of the program is to help consolidate the decentralization process in Colombia which requires: (i) ensuring that departmental and local governments are fiscally sound; and (ii) strengthening the capacity of the central government to manage the tax system and correct the fiscal imbalances of local administrations.

Ensuring fiscal viability at the local level will require introducing economic reforms in the departmental and local governments (DLGs), including measures designed to bring their finances back into balance. The present program will reinforce this effort by providing institutional strengthening for DLGs aimed at modernizing their tax administrations and making certain that the reforms are sustainable.

At the same time, the program seeks to improve the central government's capacity to manage intergovernmental fiscal relations. Hence, the program will bolster the relevant institutions at the central level and improve the information available on regional indebtedness by creating a Registry of Debt and Guarantees (REG).

DESCRIPTION:

The Ministry of Finance and Public Credit (MFPC) will head the program and provide the means for bringing about structural change in the DLGs. The multilateral agencies will make disbursements to FINDETER as an advance of funds, and the latter will create a fund to finance the programs for modernization and reform of local governments.

Before receiving resources from the fund, the DLGs must submit a Local Government Economic Reform Plan (PRET) to a Loan Committee (CC) for approval. The DLGs benefitting from the program must provide assurances that they will carry out the economic reforms within their jurisdictions. With this in mind, they will be required to set specific fiscal performance goals and take the necessary steps to meet these targets. Funds will be disbursed to the DLGs in tranches when the goals have been reached and upon completion of the specified activities. Resources from the fund are expected to finance activities in approximately 10 DLGs.

These resources will be allocated through the financial intermediaries (FIs) which will rediscount the loans with FINDETER and assume between 50% and 80% of the overall risk. The remaining risk will be covered by the central government through a trust created for this purpose.

Evaluation and monitoring of compliance with the performance agreements will be the responsibility of the Central Technical Unit (UTC), which will report to the CC and be made up of members of the Ministry of Finance's Fiscal Support Directorate (DAF) and FINDETER.

The resources will be used by departmental and local governments to fund: (i) administrative reforms; (ii) transfer of assets (privatization, granting of concessions, etc.); and (iii) technical assistance in tax administration, financial administration and management of human resources.

At the central level, the resources will be used to finance: (i) the institutional strengthening for the

DAF, which will help the UTC to evaluate and supervise the program; and (ii) the creation of the REG, which is necessary to improve the quality of data on taxes levied by the DLGs.

ENVIRONMENTAL CLASSIFICATION: At its meeting of May 7, 1996, the Environment Committee classified this as a Category II operation.

APPROVAL PROCEDURE: In accordance with the rules adopted by the Board of Executive Directors (Document DR-398-2), this proposal must be placed before the Committee of the Whole for approval inasmuch as it contains innovative features.

BENEFITS: Carrying through on government decentralization is one of the objectives laid down in Colombia's constitution, and its achievement will have a positive impact both on the country's ability to provide social services, and on the willingness of the public to participate in the decision-making process.

The proposed program will aid in the consolidation of the decentralization process. Specifically, it is designed to strengthen departmental and local governments by means of institutional modernization and reform so that they can balance their budgets. Since most of the country's spending on social sectors is allocated by the DLGs, the program is also expected to result in greater efficiency in the delivery of social services. As well, the institutional strengthening of the DLGs' will help raise the profile of the State in areas where, traditionally, there has been little respect for the exercise of public authority.

Moreover, the program will not only strengthen the technical capacity of the DAF, but will also upgrade and improve the leadership capacity of other institutions in the central government. This leadership by the central government will be accompanied by a systematic attack on fiscal deficits at the local level, which will give greater transparency and credibility to both the institutions themselves and the mechanism employed.

Creation of the REG will likewise help to generate timely and reliable data on taxes levied by the regional administrations. This will have a positive effect both on fiscal administration at the central and local levels alike, and on the effort to ensure transparency in the granting of loans by the FIs.

Accordingly, under this program a mechanism will be created enabling governments to respond systematically to the need for reform of public finances and strengthening of the institutions responsible for tax management at the regional level.

Given the importance placed on administrative restructuring in the reforms being introduced in the DLGs, one of the main items of expenditure under the program will be the separation package for personnel displaced by the process and whose positions are eliminated. This item will account for nearly 60% of the total cost of the program, but is considered essential for pressing ahead with the modernization of government at the subnational level.

This activity will be supplemented with strengthening for institutions in the public sector that are responsible for fiscal management, pursuant to the mandate of the Eighth Replenishment of Resources concerning modernization of the State and deepening of the process of decentralization.

RISKS:

The main risk in this operation has to do with the sustainability of the reforms. The success of these initiatives is directly dependent on the political support that they receive from governors, mayors and their respective legislative bodies. A change in political leadership at the district and municipal level could signify a possible reversal of the reforms.

The assessment and oversight duties of the UTC to be created under this program is therefore vital. And to further mitigate this risk, program funds will be disbursed in tranches to remove any possibility of improper use of resources.

Another risk stems from the participation of FIs in the program, and the chance that some beneficiaries may turn out to be poor credit risks. To counter this risk, the government will establish a trust covering a variable percentage of each transaction, ranging from 20% to 50% of the amount of individual loans. In addition, the Loan Committee (CC) will be empowered to change the lending spreads in the event that these prove inadequate for ensuring participation by the FIs.

THE BANK'S COUNTRY AND SECTOR STRATEGY:

In August 1995, the Board of Executive Directors of the IDB approved the country programming paper for Colombia (GN-1886) setting out the Bank's strategy for that country during the 1995-1997 period.

The strategy adopted is based on a study of the principal challenges that the country will face over the next few years, and involves a three-pronged attack: (i) supporting direct investment in the social sectors as a means of alleviating poverty and raising the standard of living of the population; (ii) strengthening the management of public institutions in order to make public expenditures more efficient; and (iii) encouraging greater private sector participation through a series of initiatives aimed at increasing economic productivity. The proposed operation is specifically identified in the CPP.

PROCUREMENT THRESHOLDS:

Procurement will be done by international competitive bidding for contracts valued at US$350,000 or more in the case of goods and related services and US$200,000 or more in the case of consulting services.

SPECIAL CONTRACTUAL CONDITIONS:

As a condition precedent to the first disbursement of the loan, the borrower must submit:

1. Evidence that the REG has been duly created (see paragraph 3.19).

2. Proof that the Credit Regulations and model contracts required for the program have been approved (see paragraph 2.20).

3. Tentative schedules for: (i) processing the PRETs; and (ii) disbursements to local government administrations (see paragraph 3.34).

4. Proof that the Operating Regulations for the trust fund have been drafted and approved (see paragraph 3.14).

5. Evidence that the UTC had been set up and the corresponding personnel designated (see paragraph 3.5).

Additional contractual conditions are described in the following paragraphs: 3.35 (advance of funds of up to 20%), and 3.43 (final evaluation).

IMPACT ON POVERTY:

Not applicable.